

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 99-11**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of pollution control credit to petroleum company.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

**FACTS**

[THE TAXPAYER] is in the business of selling petroleum products at retail and wholesale levels. The Taxpayer is greatly impacted by rules and regulations issued by the U.S. Environmental Protection Agency and the Tennessee

Department of Environment and Conservation. To comply with these regulations, the Taxpayer must purchase required equipment or sublet the installation for a petroleum distribution location. The equipment used is as follows:

1. Operational equipment:

a. Tanks, underground storage; cathodically protected, double wall. These are underground storage tanks used for the storage of petroleum products such as gasoline, diesel fuel and kerosene. The phrase "cathodically protected" refers to a procedure used to retard the rust and corrosion of an underground storage tank and is required pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.02(1)(a)(2). The double wall refers to the underground storage tank. A double wall tank is literally a tank within a tank. The purpose of having two walls is to contain the petroleum product within the second wall if the first wall should fail. Also, the exterior wall protects the interior wall from rust and corrosion. The only purpose for the second wall is to prevent the release of petroleum products into the environment.

b. Tanks, aboveground storage; double wall. This refers to above ground storage tanks used to store petroleum products such as gasoline, diesel fuel and kerosene. As noted above, a double wall tank has a second wall that prevents the release of petroleum products into the environment.

c. Supply piping; cathodically protected, double wall. Supply piping refers to pipe through which petroleum products run either to or from an above ground or underground petroleum storage tank. As with the tanks discussed above, these pipes are cathodically protected, pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.02(1)(b) and (2)(c), and double walled. As with the tanks, the purpose of a double walled pipe is to prevent a release of petroleum products into the environment if the first wall fails.

d. Overfill devices; electronic/mechanical. Overfill devices are designed to prevent a tank from being over filled. Much in the same way that a glass can be over filled with water and spill onto a counter, a storage tank can be over filled. If a storage tank is over filled, petroleum products typically overflow and are released into the environment. Overfill devices were created to prevent these occurrences, pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.02(1)(c). An electronic overfill device is a buzzer that sounds when the tank is 95% full and prevents any additional petroleum product from entering the tank.

e. Spill containment devices. The most common spill containment device is a five gallon OPW. In essence, this is a container wrapped around a tank fill line. If the tank is over filled, the product is contained in the "bucket." Also, the second wall in a double wall tank or pipe is also a spill containment device. Spill

containment devices are required pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.02(c).

f. Stage I vapor recovery devices. In essence, a Stage I vapor recovery system is piping that runs from a storage tank back to the truck from which the tank is being filled. As the tank is filled by the truck, the liquid pushes petroleum vapor out into the environment. The purpose of the Stage I vapor recovery system is to force the petroleum vapor back into the truck instead of allowing it to be released into the atmosphere.

g. Stage II vapor recovery devices. A Stage II vapor recovery device is located on the nozzle of a gasoline pump and causes petroleum vapors that would otherwise escape into the environment to be forced back into the tank. These are not currently required in the Taxpayer's area.

## 2. Leak detection

a. Automatic tank gauge system. An automatic tank gauge system is a device that automatically measures the amount of petroleum product in a tank, pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(a). The device can be either used on demand to calculate the gallons in the tank at a particular time or can be programmed to check the tank's inventory periodically. The information from the automatic tank gauge is reconciled against sales from and deliveries to the tank to determine whether the tank is losing gasoline. For instance, if the tank starts the day with 1,000 gallons, sells 500 gallons, and receives a delivery of 500 gallons, then at the end of the day, the automatic tank gauge should show that the tank still has 1,000 gallons. If the automatic tank gauge shows that the tank contains less than 1,000 gallons, this may indicate a leak in the tank.

b. Statistical inventory reconciliation. A statistical inventory reconciliation system involves gathering data about tank inventories, deliveries to the tank and sales from the tank. The system uses a computer, computer program, and various devices to measure the tank's inventory. Inventory control is required pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(a).

c. Tank tightness testing. Tank tightness testing involves the placing of the contents of a tank and/or lines under pressure to determine whether there are any leaks pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(c). For instance, the contents of the tank might be filled with a pressurized gas. If the pressure in the tank and/or the lines falls, this is indicative of a leak.

d. Interstitial monitoring equipment. Interstitial monitoring equipment is a probe or sensor that is contained between the walls of a double walled tank or line pursuant to Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(g). The purpose of this device is to send a signal in the event that petroleum vapor is detected

between the walls of the tank or line. The warning signal is sent to a device that sounds an alarm.

e. Vapor monitoring equipment. Vapor monitoring equipment is a probe that is placed in a well that has been drilled in the vicinity of a tank. The probe measures whether any petroleum vapor has entered the well. The presence of petroleum vapor may indicate a leak from the tank. Vapor monitoring equipment is required in Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(e).

f. Water monitoring equipment. Water monitoring equipment is used to detect whether petroleum has come into contact with water in the vicinity of a tank. The equipment is placed into wells that are drilled in the vicinity of a tank. Water monitoring is required in Tenn. Comp. R. & Regs. 1200-1-15-.04(3)(f).

g. Leak detection devices (tanks and/or lines). Any of the devices listed in subsections (a) through (f) above are leak detection devices required under Tenn. Comp. R. & Regs. 1200-1-15-.04(4). In addition, there are systems that automatically shut off pumps in the event a leak is detected in the lines or tanks. These devices will shut off the pump if pressure in the system falls below ten pounds per square inch.

### 3. Miscellaneous:

a. Cathodic protection systems. Cathodic protection ("CP") refers to a system that is used to retard the rust and corrosion of storage tanks and is required in Tenn. Comp. R. & Regs. 1200-1-15-.02(a)(2). There are two kinds of CP: passive and active. In passive CP, anodes are connected to the tank by wires and buried around the perimeter of the tank. The purpose of the anodes is to dissipate electrical charges that are contained in the ground and which are absorbed by the tank. The electrical charges are important ingredients in the rusting and corrosion of tanks. By using the anodes and dissipating the electrical energy, the rusting and corrosion of the tank can be slowed significantly. Active CP involves using wires connected to the tank through which a low voltage electrical current is run. This current counteracts the natural electric charges found in the soil around the tank.

b. Inventory control equipment. Inventory control can be performed by two of the above described methods: an automatic tank gauge system and a statistical inventory reconciliation system. Inventory control may also be performed mechanically by an apparatus installed into the underground storage tank. The product level is determined by floats on the product surface indicating inches which in turn can be converted to stored gallons. Inventory control is required under Tenn. Comp. R. & Regs. 1200-1-15-.03(a).

c. Emission reducing devices. Emission reducing devices are installed in petroleum storage systems to regulate the amount of volatile organic compound

that is being released into the atmosphere. Stage I and Stage II are two of the methods described above. Also, restrictive vent caps are installed on the vent lines which regulate the amount of volatile organic compounds released via pressure build-up on petroleum storage systems.

d. Environmental abatement equipment and materials. This is various equipment and materials used to abate a release of petroleum products into the environment. It includes pads or booms made of absorbent material and used to soak up petroleum products on the ground. Likewise, various companies manufacture a sawdust-like material that is used to absorb oil for later disposal.

e. Break-away devices. There are two types of break-away devices: those located at the base of a pump, and those located on the pump hose. The purpose of break-away devices is to stop the flow of petroleum products if a violent event occurs, required by Tenn. Comp. R. & Regs. 1200-1-15-.02(1)(c). For instance, if a car knocks over a gasoline pump, the break-away device will inhibit gasoline from flowing freely into the environment. Similarly, if a car drives away from a pump with the nozzle still in the gas tank, the break-away device on the hose will prevent gasoline from spewing into the environment if the car pulls the hose off the pump.

## **ISSUE**

Whether the items described above qualify as pollution control and are exempt from sales and use tax pursuant to Tenn. Code Ann. § 67-6-346.

## **RULING**

The items, with the exception of the Stage II vapor recovery device, the automatic tank gauge system, the statistical inventory reconciliation, the inventory control equipment, and the environmental abatement equipment and materials, qualify for pollution control and are exempt from sales and use tax pursuant to Tenn. Code Ann. § 67-6-346.

## **ANALYSIS**

Tenn. Code Ann. § 67-6-346 was originally enacted as Chapter 873 of the Public Acts of 1992. The legislative history and the act itself evidence an intent on the part of the General Assembly to assist businesses, through the tax code, in complying with newly enacted environmental laws. For example, the act states, "WHEREAS, Provisions of the federal Clean Air Act and the federal Clean Water Act will mandate substantial expenditures by small businesses in Tennessee in

the near future . . .” Sections one and two target specific industries - automobile paint shops and dry cleaners. Section three is a “catch-all” provision for “pollution control required . . . in order to come into compliance with” environmental laws and which is not eligible for any other credit. The provision has been amended three times and now reads:

There shall be a credit of one hundred percent (100%) of the sales and use tax paid with respect to any pollution control required to bring the purchaser into compliance with pollution control laws or regulations, whether federal, state or local. Instead of taking the credit available under this section or § 67-6-507(i) and (j), the purchaser may apply to the commissioner of revenue for a refund of the taxes paid or for authority to make purchases exempt from tax.

Exemptions are to be strictly construed against the taxpayer. *Shearin v. Woods*, 597 S.W.2d 895 (Tenn. 1980).

It is clear that the General Assembly intended Tenn. Code Ann. § 67-6-346 to benefit and support those businesses that create pollution or waste in the course of their operations and which are mandated by law to control, treat or dispose of those wastes.

Based on the information provided, the Taxpayer has demonstrated through the above descriptions and references to state environmental administrative requirements that the above items are pollution control, with several exceptions. The information provided by the Taxpayer does not establish that the Stage II vapor recovery device and environmental abatement equipment and materials are required by federal, state, or local regulations. Accordingly, the Stage II vapor recovery device and environmental abatement equipment and materials do not qualify as pollution control. Additionally, the environmental abatement equipment and supplies appear to be items used for the purpose of cleaning up a spill or leak and do not constitute a required method of controlling, treating, or disposing of waste created during the course of business. If the Taxpayer can demonstrate to the satisfaction of the Department that these items are both required by federal, state, or local law or regulation and are used for pollution control, the Stage II vapor recovery device and environmental abatement equipment and materials may be exempt. Based on the facts provided, however, these items are subject to sales and use tax.

The automatic tank gauge system, statistical inventory reconciliation, and inventory control equipment, although required by the regulations, do not perform true pollution control functions. Although the gauge system can be used to detect a leak by comparing starting and ending levels of petroleum, this appears to be used primarily for inventory purposes. Similarly, the inventory reconciliation does not appear to serve any purpose other than gathering data about

inventories for sales purposes. Inventory control equipment may be in the form of the automatic tank gauge system or statistical inventory reconciliation and is likewise not exempt.

The remainder of the items, however, are exempt from sales and use tax as required pollution control pursuant to Tenn. Code Ann. § 67-6-346.

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APPROVED: Ruth E. Johnson, Commissioner

DATE: 3-24-99